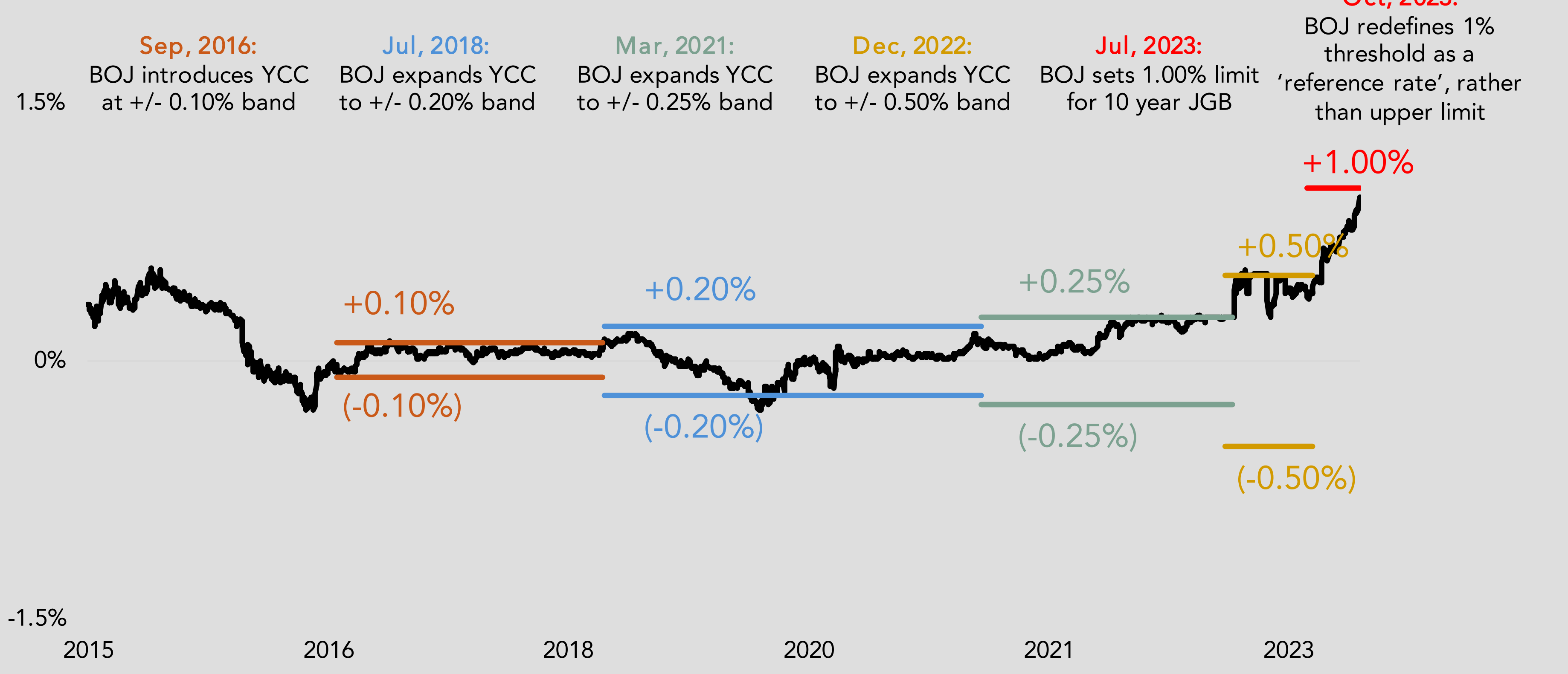
Capital Markets Strategy
Essential inSights for the C-Suite

MUFG

Policy Note

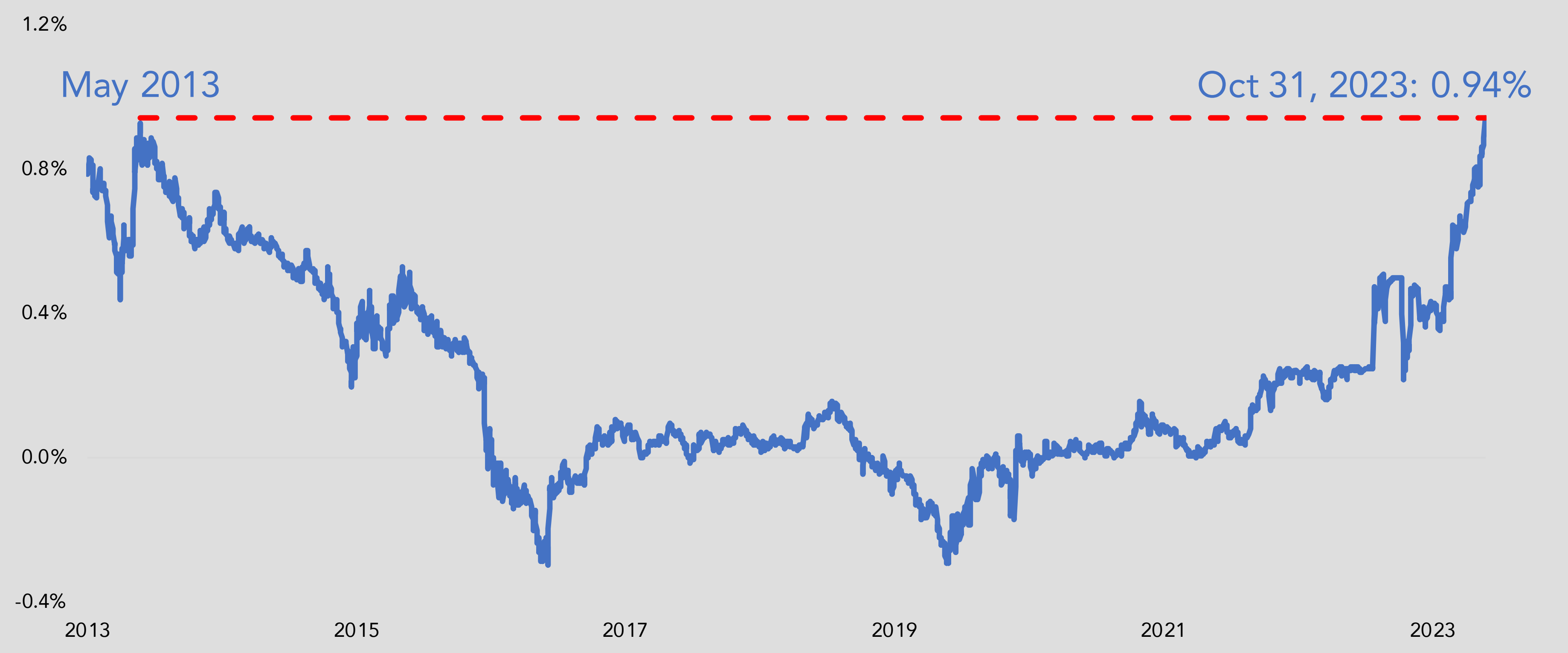
Earlier today, the BOJ made yet another significant adjustment to its 7 year YCC policy of capping 10 year JGB yields, having previously adjusted the policy just three months ago in July. Today, the BOJ eliminated the existing +/- 0.5% target range which had become irrelevant, and changed the 1% cap on 10 year JGB yields to more of a "reference rate" than a firm upper limit. In doing so, the BOJ took a large step in the direction of policy normalization by allowing the market to play a larger role in determining yield.

Japan 10 year government bond yield



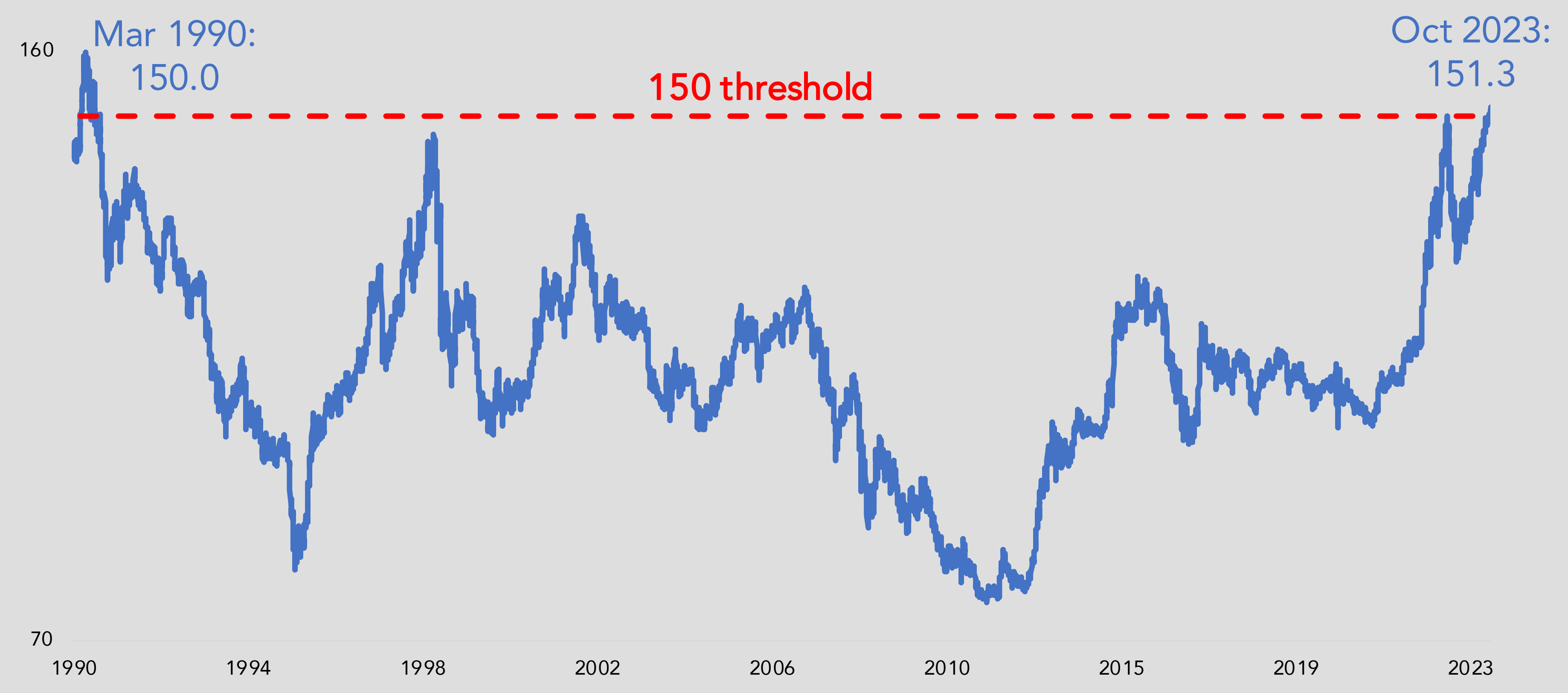
10 year JGB yields traded as high as 0.95% earlier today, their highest level in over a decade. The continued march higher in UST yields had been forcing the BOJ to draw down its $1.3 trillion in FX reserves to purchase enough JGBs to keep Japan's 10 year yield below the 1% policy cap. The BOJ's adjustment to YCC today will allow smoother functioning of the JGB market by reducing the amount of market intervention, thereby clearing a path closer to policy normalization.

10 year JGB bond yields

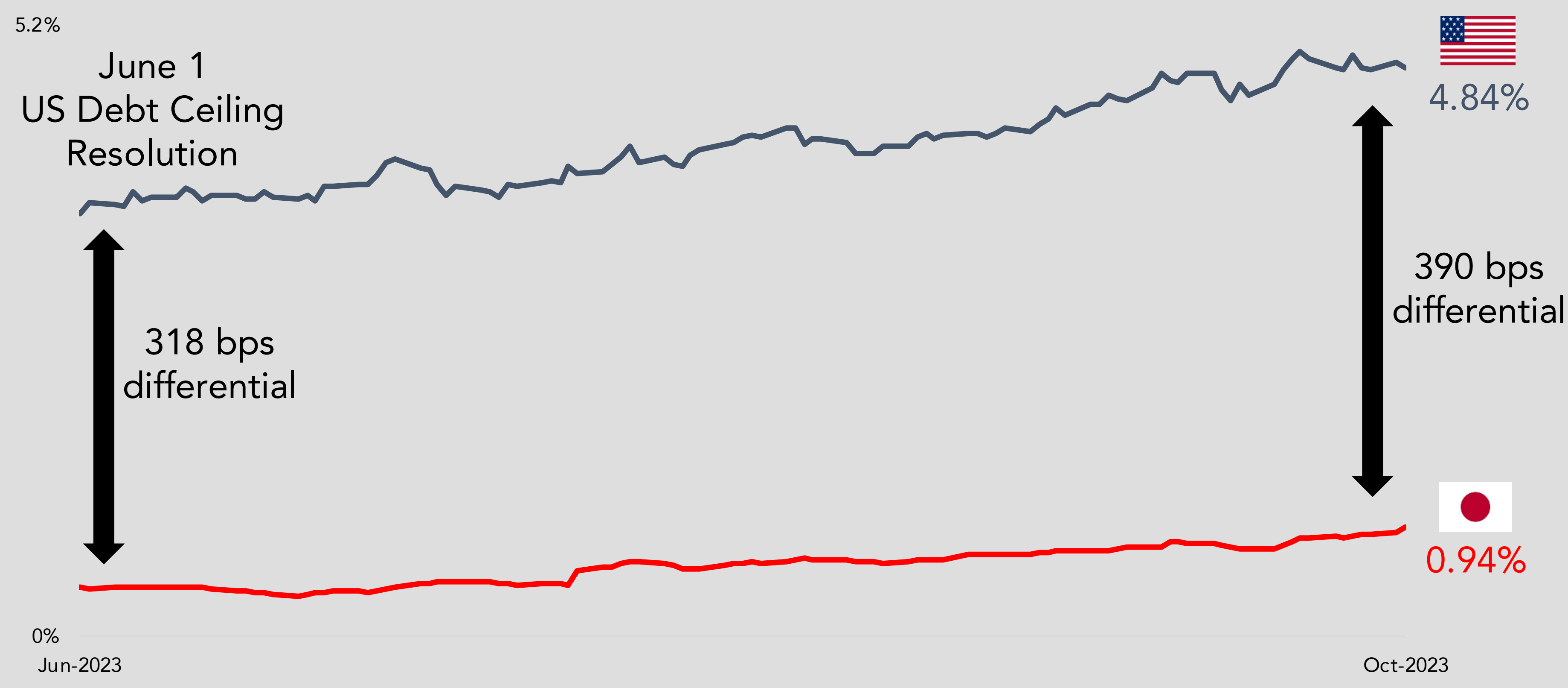


With the 10 year UST yield rising rapidly since June 1, rate differentials have become an important driver of the move in USD/JPY above 150, its weakest trading level since Japan's property crisis in the early 1990s.

USD / JPY

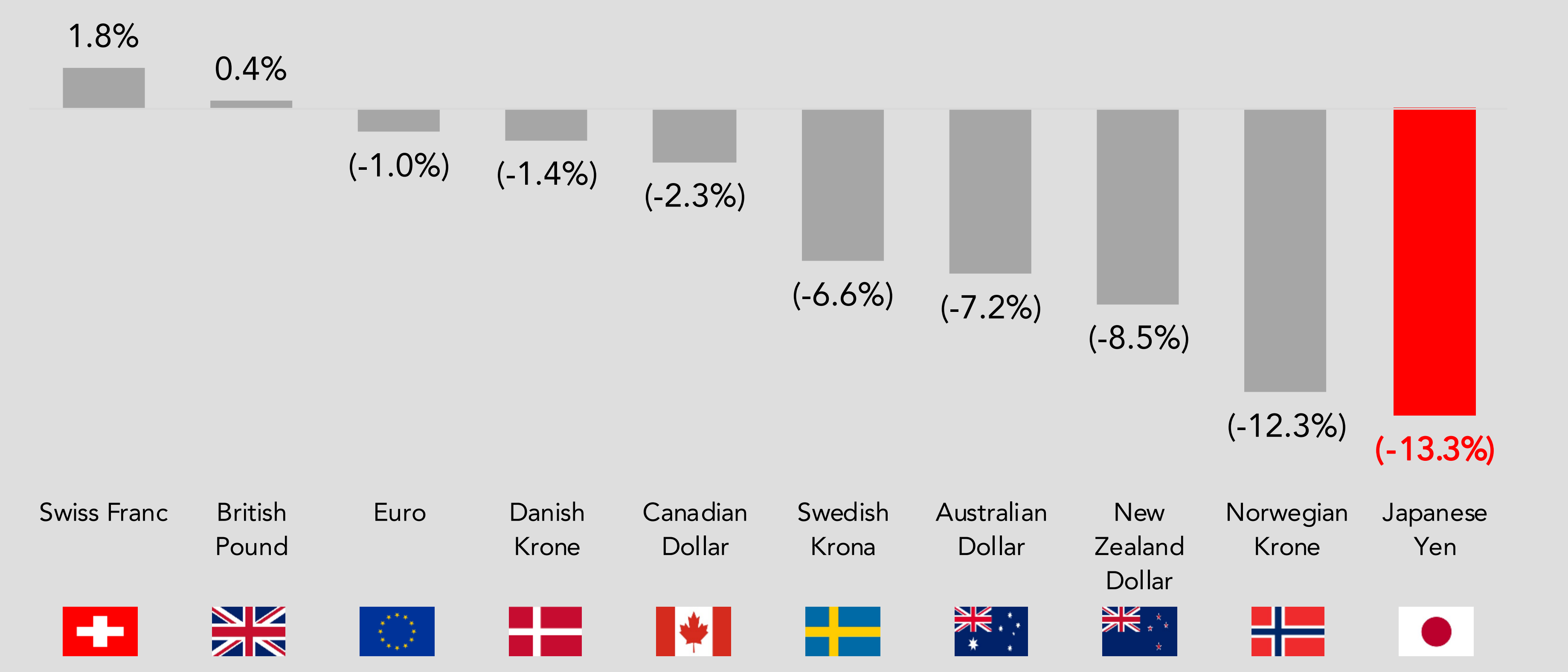


10 year UST and 10 year JGBs



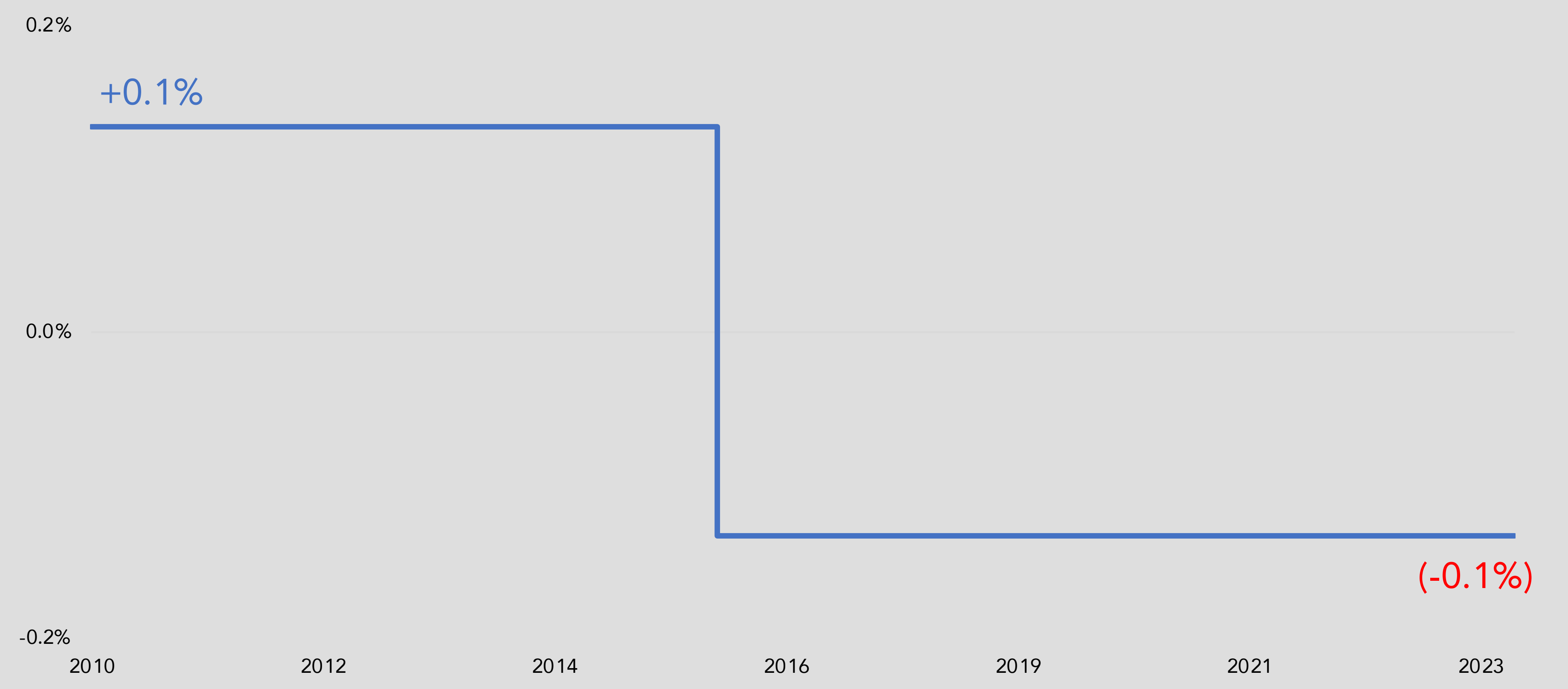
Down more than 13% YTD, the Yen has been the worst performing G10 currency in 2023, and is more than 40% undervalued on a PPP basis.

G10 currencies vs. USD YTD



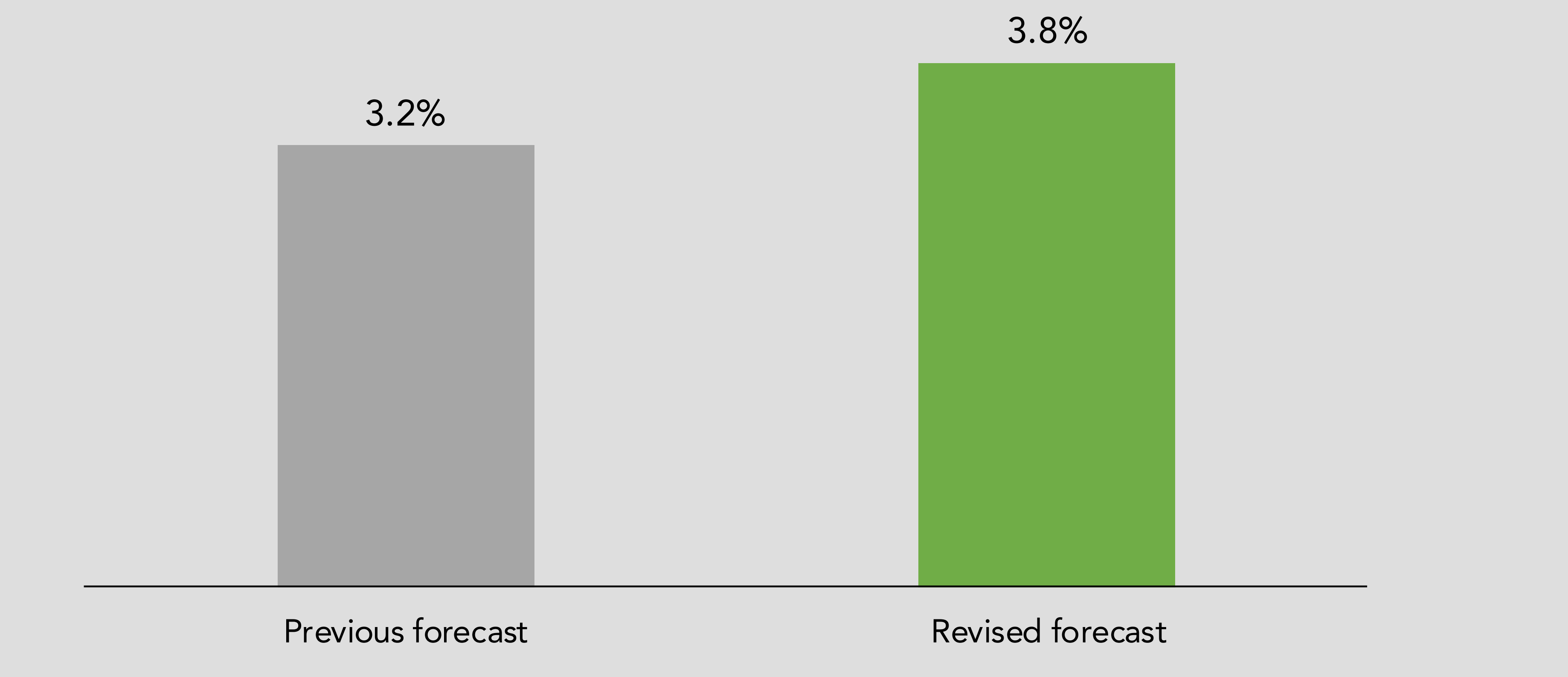
At the October 31 meeting, the BOJ left its benchmark policy rate at (-0.1%), the world's only negative policy rate.

BOJ benchmark policy rate



Higher import prices were a primary driver of Japan's 4.2% core inflation rate in September. Against a backdrop of persistent Yen weakness and higher recent inflation prints, the BOJ today raised its core inflation forecast for FY2023 from 3.2% to 3.8%.

BOJ FY 2023 core inflation forecast



Source: (1-7) Bloomberg. Data as of October 31, 2023.

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"Macro stability isn't everything, but without it, you have nothing."